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RURAL CO-OPERATIVE BANKS OF INDIA: TOWARDS THE NEXT "BANKING ORBIT"

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Abstract

Rural Co-operative Banks (RCBs) play a crucial role in day-to-day lives of rural population. Happenings in recent years have called to question the relevance and purpose of the RCBs. RCBs will face a far more competitive environment in the coming years relative to what was. The evolving regulatory and supervisory landscape emerging for cooperative banks, the developments in the rural business will also need to be factored in as RCBs set about readjust their survival plans. Rural people are finding difficulties in identifying suitable products from a large volume of information leads to an information asymmetry between the bank and the rural customer. In such a situation, financial education can greatly help the consumers to narrow this information divide. Financial literacy efforts involves educating them about the benefits of being part of the formal financial system and managing short term volatility in incomes and meeting unexpected emergencies without getting trapped in unnecessary debt. RCBs cannot move up to the next stage of banking unless all necessary safeguards have been validated by the regulators/supervisors. Regulators/supervisors have a key role in overseeing the RCBs' transition to the next stage. RCBs have a critical role to play in ensuring that they are equipped with the necessary skills to deal with rapidly changing rural economic scenario.

Key words:-Rural Co-operative Banks, rural banking ,Central Cooperative Banks, Primary Agricultural Cooperative Societies, State Cooperative Banks.

Introduction

Being a part of the rural banking system, which forms the core of the financial architecture of the Indian economy, Rural Co-operative Banks (RCBs) can influence the economic lives of the rural populace. RCBs play a silent, yet crucial part in day-to-day lives of rural population. The RCBs perform financial intermediation by pooling savings and channelizing them by giving agricultural and farm-allied credit, thereby keeping the rural economy's growth engine active. The Committee on Financial Sector Assessment (CFSA) had reviewed RCBs and made few recommendations for improving the financial health and systems for attaining and maintaining their stability. The suggestion by the Prof. Vaidyanathan Committee for RCBs was to maintain a minimum risk weightbased capital requirement of 7 per cent. In subsequent period of times another Committee chaired by Dr Prakash Bakshi noted that the share of RCBs in providing agricultural credit has fallen to a mere 17% at the aggregate level although there are small pockets where its share is more than 50%. The Committee observed that almost 40% of the loans provided by Primary Agricultural Cooperative Societies (PACS) and almost half the loans provided by Central Cooperative Banks (CCBs) are for non-agricultural purposes, although the share of many of these PACS and CCBs in agricultural credit was less than 30% in their operational area and noted with concern that these RCBs were not performing the role for which they were constituted. The Committee therefore recommends that RCBs should strive to provide at least 70% of their loan portfolio for agriculture.

Challenges before RCBs

Now how to push RCBs the next orbit of banking? This is, arguably, even more relevant today than few years ago. Two consecutive expert committee reports on cooperative banking (Prof. Vaidyanathan Committee and Report of the Expert Committee to examine Three Tier Short Term Cooperative Credit Structure by Dr Prakash Bakshi) shows, the future of rural co-operative banking continues to be grim. Rural co-operative banking sector is facing significant challenges. Asset quality of RCBs has come under increasing pressure with rising NPAs and restructured loans.

Having seen the challenges before the rural co-operative banking system the paper dealt with the issue of taking the rural co-operative banking Sector towards the next orbit. Are we comfortable with the dynamism and stability of rural co-operative banking system? What do we actually wish to achieve by taking the rural co-operative banking sector to the next orbit? Whether the regulatory community and rural community are satisfied with the rural co-operative banking system as it exists today? Happenings in recent years have called to question the relevance and purpose of the rural co-operative banking sector. A large number of Central Cooperative Banks and some State Cooperative Banks do not have adequate capital to meet even the relaxed licensing norm of 4% CRAR. Failures of RCBs at regular interval leave little scope for doubt that the cooperative banking sector discredited. Thus, the Cooperative Bank has to play a purposeful and relevant role in the economy if it has to regain its credibility. It will have to develop the necessary fire power and stability and move to the next generation banking.

What are the key drivers for propelling the rural co-operative banking sector forward? Which are the key factors that will determine whether the rural co-operative banking system is able to transform itself into a relevant, purposeful and credible institution? What are the major challenges and hurdles ahead? What are the major goals that the rural cooperative banking sector has to achieve in coming years? The key drivers and challenges for the rural co-operative banking system originate from different sources.

First, the regulatory environment in which RCBs in India are functioning. So many controlling authority i.e. RBI,NABARD , State Government and additional capital requirements of at least 7% by 2014-15 and of 9% by 2016-17 change the landscape of RCBs. There is a need of RCBs to fine tune their risk management systems. New branch licensing policy of compulsory opening of branches at rural areas, change in approach of private banks towards rural sector, aggressive branch opening policies of public sector banks in rural areas and regulatory policies are likely to result in RCBs facing a far more competitive environment in the coming years relative to what was. As cooperative banks' customers – both businesses and individuals - become national, RCBs will also need to develop national ambitions. The challenge for RCBs will be to develop new products and delivery channels that meet the evolving needs and expectations of its customers.

Customer knowhow

A growing demand on banking facility on unbanked zone, financial inclusion and improved Know Your Customer (KYC) practices will require RCBs to relook their business old practices, their data and information systems, and the mindset of human resource, if RCBs have to remain relevant, going forward. The evolving regulatory and supervisory landscape emerging for cooperative banks, the developments in the rural business will also need to be factored in as RCBs set about readjust their survival plans. For instance, in line with national developments, RCBs has to initiate steps for giving a unique customer identification number for all customers accessing the formal financial system. RCBs have to ensure that within each bank a customer is assigned a unique customer identification file and that there should not be instances of multiple customer identifications for the same customer. This is important both from the point of view of effective monitoring of anti money laundering and better management of customer business.

From a regulatory perspective, rural co-operative banking service providers have to understand the business activities of their customers so that they do not, end up being mediums for unlawful activities such as terrorism, frauds transactions, etc. From a business perspective, Know Your Customers' Business (KYCB) is important for understanding the nature of the customer's business, which would help in offering suitable products, managing credit exposure and generating early warning signals for potential delinquency risks. KYC compliance is effectively conveyed across the agricultural societies by the Cooperative Banks, not just for meeting regulatory requirements, but as an opportunity to understand the customer better and maximize the gains from the customer relationship.

Internal Control

Frauds are a serious cause for concern for the rural co-operative banking system. Frauds do not just represent lost money; they also indicate serious gaps in internal systems and processes and in the internal control framework. Cooperative Bank has to plug the gaps and establish sound system for identifying accountability and taking stringent action against the persons responsible for the frauds. This is very important for tackling the drainage of common men hard earned money. It results in a loss of confidence of customers in rural co-operative banking system and could have severe adverse implications, particularly at a time when RCBs are struggling hard for regaining customer confidence. All these developments will pose a threat for the rural co-operative banking system. RCBs will need to face them frontal in the coming years. RCBs have to look inwards – at their technology management, information systems and human resource management. RCBs will need to relook the effectiveness of their employees about credit disbursement and fund management. These will be the key factors for change if RCBs are to gear up in the changed environment and move into the next orbit.

Risk Mitigation

The need of risk management has been steadily growing over the last few years. This can be attributed to several developments in the Cooperative sector over the last few years. First, the deregulation of financial markets led to increased volatility placing greater demands on banks to manage their risks. Banking activities of RCBs diversified from the traditional function of lending and borrowing to a larger set of activities including, inter alia, treasury and custodial services. The role of money market instruments and consortium finance in rural co-operative banking expanded with increasing growth. The collapses of many RCBs have further accentuated the importance of risk management frameworks for Cooperative Banks. Most of the RCBs have no orientation towards identifying risks and tracking the passage and path of risks so as to be able to price the risks appropriately. RCBs should work on upgrading its risk identification, management and pricing abilities. RCBs lack in framing complete risk management and hardly an effective system of internal controls and methodologies. The first line of defense for risk management has to come from bank managements and, especially, from bank boards. RCBs should develop a proper culture of risk management and internal control. In indirect lending the hallmark of success lies in the active functioning of PACs. Serving PACs is, essentially, the reason why the RCBs exist in the first place. But over the years PACs has become rather peripheral in the Cooperative banks' functioning. RCBs must make use of technology to deliver banking products and services in a cost-effective manner. Educate the rural customers so that the user can have the ability to choose appropriate and need based products and technology services. Unless the rural RCBs become rural customer centric in all its dimensions, it would fail to attain sufficient momentum to keep it rural customer segment.

Human Resource Management

Banks that are operating in rural belts have similarity in product offerings. The prevalence of the three-tiered structure in shot term cooperative credit structure leads to an increase in transaction cost that diminishes profit margins.

Here employees' service could be the edge over rivals. In banking industry skills, technology and human capital are the prime factors of success. Employees make the difference between success and failure. The challenge before RCBs is to impart training at regular interval and to make them more technology oriented for reaping the benefit of CBS (Core Banking System) and delivery channels like ATM, Mobile Banking etc. By effectively utilizing its workforce RCBs could quickly bring in more and more financially excluded people under the ambit of the formal banking system. Interference by the elected board in the day-to-day management of these banks and officials from the state government deputed to these banks may have neither the professional skills nor the requisite experience to run the banks aggravate the issue further, though recent initiatives of incorporating fit-and-proper criteria for the CEO and directors is expected to alleviate this problem(Bakshi ,P.).

Promoting Financial Literacy

Very recently the news of the collapse of Sharada Chit Fund group spreads like wildfire across the state of West Bengal. Investors are weeping inconsolably and rush to the police stations to ask how they can recover their lost cash. But no one can offer any words of hope. People have committed suicide over the scam, including agents of the operators of the Ponzi scheme. The markets regulator, the Securities and Exchange Board of India, or S.E.B.I., says the recent chit fund scam has resulted in at least 32000 crore rupees in losses and has affected 33 lakhs people, making it one of the biggest financial fraud cases in India. The failure of bankers to reach at common man giving the opportunity to chit fund operators fleeing with crores of rupees belonging to gullible investors are not new to none of us. How to keep away people from such schemes? RCBs have to play a strong role by liberating the consumers about the financial products. One cannot expect to make major development in rural area unless rural populations are not well aware about the financial products. Financial literacy has significant importance for rural population. It involves two elements, one of access and the other of awareness. Inadequate financial infrastructure and the access to financial products/services is a matter of concern. The access and awareness need to be stressed, with improving access assuming greater priority. Financial literacy involves imparting knowledge about the risk and return of financial products to the users and providers of these products. Financial literacy is an essential pre-requisite for ensuring consumer protection. Rural people are finding difficulties in identifying suitable products from a large volume of information leads to an information asymmetry between the bank and the rural customer. In such a situation, financial education can greatly help the consumers to narrow this information divide.

Whom to literate?

This includes resource-poor, low, middle and high income group individuals. For the resource-poor population, which operates at the margin, vulnerability can be acute due to constant financial pressures. Household cash management can be daunting under difficult circumstances, with few resources to fall back upon. Financial literacy efforts involves educating them about the benefits of being part of the formal financial system and managing short term volatility in incomes and meeting unexpected emergencies without getting trapped in unnecessary debt. In India, around 60 per cent of labourers surveyed stored cash at home and during the time of need borrow from moneylenders at high interest rates. Regular savings habit in bank is bound to lessen financial vulnerability of these labourers. PACs should take the initiative of educating these excluded sections and motivate them for participation in formal banking system.

How to spread awareness by RCBs and PACs?

· By launching mass media campaigns providing simplified information in vernacular mediums, which can be used by the public to learn about the monetary and banking system.
· The involvement of Branch managers and Society Managers
· Engaging with the school committees to try and embed such concepts in the school for growing banking habit at school level. In line with the 'catch them young' strategy conducts inter school quiz competition on banking and finance, economics, current affairs, etc.
· Outreach visits to remote villages for spreading awareness about benefits of being connected to the formal financial system
· Distributing pamphlets, comic books, enacting plays and skits, arranging stalls in local fairs, exhibitions..
· Use of mobile Financial Literacy vans in rural areas
· Conduct of Financial Literacy programmes with the help of SHGs

Improving Efficiency

RCBs have to deliver products and services in a cost-effective and affordable way in an inclusive manner. The operating cost of banking to be kept at an affordable level for the common man. To extend the banking service for all section of people the banking transaction costs are brought down substantially. RCBs would need to acquire 'allocational' and operational efficiency for increasing the productivity. Allocational Efficiency will ensure that the savings of common man are allotted to the most productive activities. Higher Operational Efficiency helps RCBs providing services to its customers in a safe, secure and speedy manner with minimum cost of financial intermediation. RCBs should introspect on how it can improve on both - allocational and operational efficiency parameters- so that the financial intermediation function is efficiently performed. RCBs have to regain the trust and confidence of the rural people and retain their pivotal position in the rural India.

RCBs remained largely under prepared to overcome major operational risk due to lack of product variation and a comparatively lesser degree of integration with the national and global markets. The coming years, however, will pose big challenges for RCBs as well. The significant rise in interconnectedness of financial markets across jurisdictions, the growing complexities of banking products and services, introduction of newer delivery channels and the need for emphasizing on inclusion of the vulnerable and marginalized groups has significantly increased the challenges.

RCBs cannot move up to the next stage of banking unless all necessary safeguards have been validated by the regulators/supervisors. Regulators/supervisors have a key role in overseeing the RCBs' transition to the next stage. Regulator and supervisors need to look into the 'Fit and Proper' assessment of the senior management, operational risk management processes, internal control & audit, grievance redressal system, compliance to regulatory guidelines and prescriptions, etc.

Conclusion

RCBs are in transition times. RCBs have limited scope to grow due to geographical constraint. RCBs are going to face lot of challenges in coming days particularly from shadow banks. Shadow banks have an edge over RCBs due to their ability to lower transaction costs of their operations, quick decision-making ability, customer orientation and prompt provision of services. Shadow banks are, sometimes, seen as akin to banks in terms of the products and services offered and have carved out niche areas of businesses, which enable them to address specific needs of the people more efficiently. RCBs have to strengthen its internal system so that it sees through these challenges and ready to thrive, as the rural sector opens up for all. In this process, while the PACs have to act as change agents within their members, RCBs have a critical role to play in ensuring that they are equipped with the necessary skills to deal with rapidly changing rural economic scenario. Rural co-operative banking system has come under increased regulator/supervisor scrutiny. A larger section of rural population financially excluded people who are waiting to be touched by the formal financial system. This is an opportunity that exists for RCBs. The potential benefits of extending banking service to the rural population would be enough to incite the rural cooperative structure and help it in getting higher market share in rural lending.

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